Saudi Telecom Co. (STC)

Result Flash Note 1Q-2017 | **May 2017**

ALJAZIRA CAPITAL الجزيرة للأسواق المالية

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STC in Q1-2017 posted earnings of SAR 2.53bn against our estimate of SAR 2.29bn, depicting a deviation of 10.2%. Revenue at 12.83bn remained in line, showing a deviation of 0.1%, whereas gross margins and operating margins showed a deviation of 0.3% and 0.9% respectively .We maintain our price target of SAR 73.5,with a "Neutral" recommendation.

- STC in Q1-2017 posted earnings of SAR 2.53bn, depicting a jump of 5.42% YoY and 21.3% QoQ. The company attributed the improved performance, albeit a 3% decline in revenue, to a 334mn increase in other income. The company's gross profit declined by SAR 357mn, however, gross margins stood at 55.2% in line with our estimate of 55.0%,higher than 53.5% realized in 1Q-2016.
- STC's revenue at 12.8bn showed a decline of 3.0%, primarily due to the economic slowdown and the impact of biometric SIM registration, which saw the company loose some of its subscribers.
- STC embarked on an operational efficiency program in late 2015, which was directed towards improving the company's efficiency and lowering cost. The first step the company took was the rationalizing of its human resource by implementing the early retirement program, STC so far has spent SAR 800mn on the program. Furthermore, the company's margins have also showed improvement, which is particularly evident in the QoQ performance, SAR 79mn jump in Gross profit despite of a drop in revenues, SAR 776mn jump in operating profit. The companies selling and marketing expense also showed a decline of 11.4%YoY in 2016.

AJC view: STC 1Q-2017 result came as a positive surprise, however the deviation was driven by higher than expected operating income. On the core income front earnings remained in line (given the 0.9% deviation in operating income). STC's performance signifies the consolidation in the telecom sector. Improved performance in short-term can be achieved by cannibalizing the market share, improving efficiency or reducing cost. STC seems to have recognized the opportunity in efficiently managing its cost, hence the early retirement program and lower cost. Based on our conservative estimates STC is expected to post SAR 8.9bn in 2017, depicting a jump of 4.3%YoY. The company is currently trading at a PE and PB of 15.82x and 2.27x respectively against forward PE and PB of 15.45x and 2.22x. We maintain our target price of SAR 73.5 with a "**Neutral**" recommendation.

Results Summary

SARmn (unless specified)	Q1-2016	Q4-2016	Q1-2017	Change YoY	Change QoQ	Deviation from AJC Estimates
Sales	13,229	13,011	12,830	-3.0%	-1.4%	0.1%
Gross Profit	7,076	6,955	7,034	-0.6%	1.1%	-0.3%
Gross Margin	*53.5%*	*53.5%*	*54.8%*			
EBIT	2,856	1,829	2,605	-8.8%	42.4%	0.9%
Net Profit	2,397	2,084	2,527	5.4%	21.3%	10.2%
EPS	**1.20**	**1.04**	**1.26**	-	-	-

Source: Company reports, Aljazira Capital

Recommendation	**'Neutral '**
Current Price* (SAR)	68.75
Target Price (SAR)	**73.5**
Upside / (Downside)	**6.9%**

*prices as of 7 of May 2017

Key Financials

SARmn (unless specified)	FY15	FY16	FY17E
Revenues	50,651	51,833	53,862
Growth %	10.53%	2.33%	3.92%
Net Profit	9,258	8,532	8,899
Growth %	-15.52%	-7.85%	4.30%
EPS	4.63	4.27	4.45

Source: Company reports, Aljazira Capital

Key Ratios

SARmn (unless specified)	FY15	FY16	FY17E
Gross Margin	59.91%	55.51%	55.46%
Net Margin	16.46%	16.52%	16.53%
P/E	14.58	16.06	15.45
P/B	2.18	2.24	2.22
EV/EBITDA (x)	6.83	7.50	7.28
Dividend Yield	5.93%	5.84%	5.82%

Source: Company reports, Aljazira Capital

Key Market Data

Market Cap (mn)	137,500.0
YTD %	-5.17%
Shares Outstanding (mn)	2000
52 Week (High)	74.00
52 Week (Low)	51.00

Source: Company reports, Aljazira Capital

Price Performance

Source: Bloomberg, Aljazira Capital

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RATING TERMINOLOGY

1. Overweight: This rating implies that the stock is currently trading at a discount to its 12 months price target. Stocks rated "Overweight" will typically provide an upside potential of over 10% from the current price levels over next twelve months.
2. Underweight: This rating implies that the stock is currently trading at a premium to its 12 months price target. Stocks rated "Underweight" would typically decline by over 10% from the current price levels over next twelve months.
3. Neutral: The rating implies that the stock is trading in the proximate range of its 12 months price target. Stocks rated "Neutral" is expected to stagnate within +/- 10% range from the current price levels over next twelve months.
4. Suspension of rating or rating on hold (SR/RH): This basically implies suspension of a rating pending further analysis of a material change in the fundamentals of the company.

Disclaimer